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Governor

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Lieutenant Governor

State of Utah
Department of Commerce
Division of Securities

FRANCINE A. GIANI
Executive Director

KEITH WOODWELL
Director, Division of Securities

June 6, 2014

David S. Evans
KIRTON MCCONKIE, PC
50 East South Temple
Salt Lake City, UT 84111

Re: American Pharmacy Cooperative
Request for Division No-Action Position
File #B01280071

Dear Mr. Evans:

The Utah Division of Securities ("Division") has reviewed your May 12, 2014 request for a no-action letter concerning American Pharmacy Cooperative (the "Cooperative"). Your request for a no-action letter from the Division is authorized by Section 61-1-25(5) of the Utah Uniform Securities Act ("Act") and Utah Administrative Code Rule R164-25-5.

Your letter requests that the Division take a no-action position with respect to issuances by the Cooperative of units of "common stock" that evidence cooperative membership. Specifically, you request that the Division staff recommend no enforcement action if the Cooperative issues such stock within the state of Utah.

Based upon the representations made in your letter and in discussions with Division staff, we will not recommend any enforcement or administrative disciplinary action, should the activities proceed in Utah as outlined in your request. To avoid unnecessary restatement or summarization of the facts set forth in your request, a copy of your May 12, 2014 letter is attached and is incorporated into our response by reference.

This response does not purport to express any legal conclusions regarding the applicability of statutory or regulatory provisions of federal or state securities laws to the questions presented. It merely expresses the position of the Division staff on enforcement or administrative actions.

As this recommendation is based upon the representations made to the Division, any different facts or conditions of a material nature might require a different conclusion.

Furthermore, this no-action letter relates only to the activities described above and will not apply to future similar factual circumstances. Finally, the issuance of a no-action letter does not absolve any party from complying with the anti-fraud provisions contained in Section 61-1-1 of the Act.

Very truly yours,

UTAH DIVISION OF SECURITIES

A handwritten signature in blue ink, appearing to read "Benjamin N. Johnson", with a long horizontal flourish extending to the right.

Benjamin N. Johnson
Director of Registration and Licensing
Utah Division of Securities

KIRTON | McCONKIE

RECEIVED
MAY 15 2014
Utah Department of Commerce
Division of Securities

May 12, 2014

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. Keith Woodwell
Director
Division of Securities
State of Utah
160 East 300 South, 2nd Floor
Salt Lake City, Utah 84111

Re: *American Pharmacy Cooperative, Inc. No Action Request*

Dear Mr. Woodwell:

We are writing on behalf of American Pharmacy Cooperative, Inc., formerly known as Alabama Pharmacy Cooperative, Inc. (the “**Cooperative**”), an Alabama corporation. On behalf of the Cooperative, we hereby respectfully request a no-action letter from the Utah Division of Securities (the “**Securities Division**”) under Section 61-1-25(5) of the Utah Uniform Securities Act, as amended (the “**Act**”), and Rule 164-25-5 of the Utah Administrative Code. Specifically, we request confirmation that the Securities Division will not take enforcement action against the Cooperative if the Cooperative sells ownership interests within the State of Utah. The basis for this no-action request is that the registration and exemption requirements of the Act will not apply to the Cooperative’s sale of ownership interests in the form of stock because such interests do not constitute “securities” within the meaning of Section 61-1-13 of the Act.

Statement of Facts

Alabama Pharmacy Cooperative, Inc. was incorporated pursuant to the Alabama Business Corporations Act on March 14, 1985. The Cooperative changed its name to American Pharmacy Cooperative, Inc., by filing the prerequisite Articles of Amendment on May 25, 1999. Upon receipt of the no action letter requested herein, the Cooperative will apply for a certificate of authority to transact business as a foreign corporation in the State of Utah.

The Cooperative was formed for the purpose of enabling member retail pharmacists (individually, a “**Member**,” and collectively “**Members**”) to aggregate their purchasing

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power and negotiate discounts on the purchase of pharmaceutical products. Currently, the Cooperative has 1,555 Members that operate 1,377 pharmacies in 23 states. Each Member is a stockholder of the Cooperative, as defined and described below. A current list of the states in which Members of the Cooperative do business, the number of stockholders in each such state, and the number of retail pharmacies participating in the Cooperative, is attached at *Exhibit A*. The Cooperative has obtained no-action or other favorable advisory letters from various states in which it is qualified to do business that are substantially similar to the no-action letter being requested from the Securities Division. Examples of such letters from the states of Arizona, Kansas, Minnesota, Iowa, New Jersey, and South Dakota are attached at *Exhibit B*.

Under the Cooperative's Articles of Incorporation (the "**Articles**") and the Bylaws (the "**Bylaws**"), all Members must be engaged in the retail business of selling pharmaceuticals. Copies of the Articles and Bylaws are attached as *Exhibit C*. Each Member pays the purchase price, presently \$1,000.00, to become a Member and receives 100 shares of the "common stock" of the Cooperative (the "**Shares**") evidencing its membership. Each Member is entitled to only one vote on all Cooperative matters, regardless of the volume of business it does through the Cooperative. The Shares are nontransferable and cannot be negotiated, pledged, assigned, or otherwise transferred, except that the Cooperative is obligated to redeem and each departing Member is obligated to sell to the Cooperative all of the Member's Shares at the price paid for the Shares in the event that (i) the Member dies or is a non-surviving party to a merger; (ii) the Member ceases to operate a retail pharmacy store; (iii) the Member ceases to do business through the Cooperative; or (iv) the Cooperative's board of directors determines that the Member is not complying with the rules or standards of the Cooperative in accordance with procedures set forth in the Bylaws. Each stock certificate bears the appropriate legend reflecting these restrictions on transfer of the Shares. Shares of the Cooperative's stock are not traded on any stock exchange or automatic quotation system.

Cooperative Members are not entitled to receive ordinary dividends on their Shares. However, under the Articles and Bylaws, the Cooperative is required to pay monthly "patronage" dividends to Members. The amount of patronage dividends is determined for each Member based on that Member's total dollar volume of business done in connection with the Cooperative in relation to the total dollar volume of all Members. Patronage dividends are not based on the number of Shares owned by a Member, since all Members own the same number of Shares. Thus, the patronage dividends are more akin to volume discounts than traditional dividends, and are simply an incidental benefit to membership in the Cooperative, the primary benefit of which being lower prices on pharmaceutical products than otherwise would be available.

In the event of a hypothetical liquidation of the assets of the Cooperative, the excess proceeds would be distributed pro rata among its Members in accordance with Alabama law. Such distribution could result in a Member receiving an amount in excess of the purchase price paid for the Shares. The Cooperative believes this result is remote, however, and is not the incentive or objective of Cooperative membership.

The Cooperative negotiates prices of pharmaceutical products with wholesale pharmaceutical distributors (collectively referred to herein as the “Vendors”). Members order such products directly from the Vendors at prices negotiated by the Cooperative, plus a mark-up based on a percentage of the negotiated price. In addition, the Vendors charge an additional one percent (1%) mark-up on generic products sold to the Members, which is remitted to the Cooperative for use in paying the Cooperative's operational expenses.

The requirements described above and the other terms and conditions of the Articles and Bylaws are acknowledged and agreed to by Members when they sign a Subscription Agreement at the time they purchase their Shares. The form of required Subscription Agreement is attached hereto at *Exhibit D*.

The Cooperative now desires to offer the Shares to retail pharmacists residing in Utah to allow them to participate as Members in the Cooperative and benefit from discounts on the pharmaceutical products they order through the Cooperative. Each subscriber would be required to warrant that it is engaged in the operation of retail pharmacy in the State of Utah. The Cooperative certifies that the offering of the Shares is not the subject of any pending or final judicial, SRO or administrative proceeding. The Cooperative certifies that it has not commenced offering membership to Utah retail pharmacies. Additionally, the Cooperative certifies that it is not currently undertaking any legal action, judicial or administrative, which relates, directly or indirectly, to the facts set forth other than the submission of this letter for the Securities Division's consideration.

Discussion

The Cooperative requests a no-action letter from the Securities Division confirming that it will not take enforcement action under the Act against the Cooperative if the Cooperative offers the Shares to retail pharmacies located in the State of Utah without registration or exemption under the Act. This request is based on the Cooperative's position that the Shares will not constitute “securities” within the meaning of the Act.

It is well settled that shares of stock are generally presumed to be a “security,” both under Utah law (*see* Section 61-1-13(ee)(i)(B) of the Act, as well as Section 2(1) of the Securities Act of 1933 (the “1933 Act”). However, it is also well-settled that the name or label of an instrument is not necessarily controlling. *See United Housing Foundation Inc. v. Forman*, 421 U.S. 837 (1975). As was demonstrated in *Forman*, courts and agencies have historically looked beyond the form of a transaction to its substance, placing emphasis on the economic realities of the situation. The Securities Division has also historically looked beyond the form of a transaction to its substance where appropriate. *See, e.g.,* TruServ Corporation, No-Action Letter, Utah Corporation Commission, Securities Division (May 24, 2001) (issuing no-action letter with respect to issuance of stock in cooperative wholesale buyer of hardware supplies); *see also*, Physician Management Company of Utah, L.C., Securities Division (March 18, 1996) (issuing no-action letter with respect to the issuance of membership units evidenced by shares of stock related to a physician network); *see also*, WestMed Physician Network, Inc., Securities Division (July 25, 1996) (issuing no-action letter with respect to the offer and sale by Westmed Physician Network, Inc. for earned membership units).

In *Forman*, the Court concluded that the stock of a housing cooperative did not constitute a security within the meaning of the 1933 Act or the Securities Exchange Act of 1934 (the “1934 Act”). In reaching that conclusion, the Court used two tests to determine whether stock in the housing cooperative was a security. First, the Court examined whether the stock possessed five characteristics that are usually present in a security, including (i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability of the stockholder to hypothecate or otherwise pledge the stock; (iv) the conferring of voting rights proportionate to the number of shares held; and (v) the capacity of the shares to appreciate in value. Second, the Court looked to *SEC v. W.J. Howey Company*, 328 U.S. 293 (1946) in determining whether the housing cooperative stock constituted an investment contract within the meaning of the federal securities statutes, and was therefore a security. The *Howey* decision focused on whether the scheme involved an investment of money in a common enterprise with profits to come solely from the efforts of others.

When applying the tests articulated in *Forman* and *Howey*, the Cooperative believes that its Shares, although called “common stock,” are clearly not “securities” within the meaning of the Act because the characteristics of stock that are, in fact, securities (as delineated in *Forman*) are not characteristics of the Shares.

First, Members will not receive ordinary dividends that are contingent upon an apportionment of profits with respect to their Shares. Members of the Cooperative will instead receive only patronage dividends, determined by and directly proportional to the total amount of purchases through the Vendors in relation to the purchases of all Members, and not by the number of Shares owned or profit derived therefrom. Consequently, there will be no relationship between the amount of a Member's dividends and the amount of its initial investment in buying the stock, presently fixed at \$1,000.00 for all Members.

Second, the second, third and fourth indicia of shares of stock that are considered to be “securities” pursuant to the characteristics set forth in *Forman* (i.e., the negotiability of the underlying shares, the ability of the owner thereof to pledge or hypothecate such shares, and the conferring of voting rights proportionate to the number of shares held) are also not characteristics of the Shares. The transfer of the Shares is restricted under the Articles, the Bylaws, the Subscription Agreement, and the stock certificate issued to Members, all of which bar the sale, assignment, pledge, disposal, hypothecation or other transfer of the Shares by any stockholder except to or in favor of the Cooperative. Similarly, the voting rights of Members is expressly unrelated to the number of Shares held under Section 4(C)(i) of the Articles, which states that each shareholder is entitled to one vote.

Finally, the incentive of Members to purchase the Cooperative's Shares is not the promise of appreciation of the Shares or the income therefrom. Because of the restrictions on transfer of the Shares, Members could not receive an amount for the Shares in excess of their investment barring the liquidation or sale of the business (not in the ordinary course), which would not reasonably be their expectation in purchasing the Shares. The Shares do not pay dividends based on the profits of the Cooperative; rather, the Cooperative pays patronage dividends to Members, which it believes to be an incidental benefit to Members, the primary

benefit being lower prices on pharmaceutical products that are available to Members participating in the Cooperative.

The Shares also fail to meet the test of an "investment contract" as articulated by the *Forman* and *Howey* Courts. The fundamental premise of an investment contract is that a person is induced to part with money with the expectation that he or she will obtain "profits" by virtue of the investment. As demonstrated by *Forman*, the Court has placed heavy emphasis on the need for the "profit expectation," notwithstanding the fact that ownership interests in cooperatives do, by a strict reading of the statute, resemble securities. The Court was clearly stating that form should be disregarded for substance and that the emphasis should be on economic reality when determining whether an instrument is, in fact, a security. As stated in *Howey*:

"The test is whether the scheme involves an investment of money in a common enterprise with profits to be derived from the entrepreneurial or management efforts of others."

The Cooperative's Members make their "profits" by their own efforts, not the efforts of others, by growing their business and placing orders for products from Vendors. Local retail pharmacies will control the amount of patronage dividends they receive by the degree of their participation in the Cooperative, not through the efforts of others. Patronage dividends, in effect, reduce the cost of goods sold.

Request for No Action Letter

Based on the foregoing, the Cooperative respectfully submits that the Shares clearly lack the characteristics of an investment security because the Shares (1) are issued by the Cooperative and purchased by the Members solely as an incident to membership in the Cooperative and are not purchased with any investment intent, (2) have no marketability, and (3) lack nearly all of the characteristics associated with a "security," as defined in the Act, the 1933 Act and the 1934 Act.

Based on the facts and discussion presented in this letter, the Cooperative respectfully requests a no-action letter from the Securities Division confirming that it will not take enforcement action against the Cooperative if it offers and sells the Shares to retail pharmacists in the State of Utah without registration or reliance upon an exemption from registration because such Shares do not constitute a "security" within the meaning of Section 61-1-13 of the Act.

As noted above, the Cooperative already does business in 23 states. In most of those states, it has requested and received a no-action or other interpretive letter from the applicable state agency in charge of securities, based on the finding that the stock of the Cooperative is not a "security" under the applicable state law. In a few states, there exists a specific exemption from registration of shares for businesses such as the Cooperative. Examples of no-action letters issued by some of such states have been provided in *Exhibit B*, and the Cooperative will gladly provide copies of additional no-action letters related to the Cooperative should you request.

Please contact me at (801) 328-3600 or by email at devans@kmclaw.com if you need additional information to make your decision. If you find that our analysis of the facts with respect to the Cooperative and its Shares or of the Act is incorrect or unsupported by the information we have provided to you, we would appreciate an opportunity to respond or to provide additional information before you issue any unfavorable written response. The undersigned acknowledges that this request may be released for publication. Thank you for your attention to this matter.

Pursuant to Rule 164-25-5 of the Utah Administrative Code, enclosed is a check in the amount of \$120.00 payable to the Utah Division of Securities to cover the required fee, together with a duplicate copy of this letter.

Very truly yours,

KIRTON MCCONKIE, PC

A handwritten signature in blue ink, appearing to read 'D. Evans', is written over the printed name 'KIRTON MCCONKIE, PC'.

David S. Evans